



[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 620

RIN 3052-AD37

District Financial Reporting

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) is amending our regulations governing how a Farm Credit bank presents information on its related associations when preparing annual bank financial statements on a stand-alone basis. The final rule provides two presentation options when disclosing related association financial information in an annual bank report: by footnote or attached in a supplement.

DATES: This regulation will be effective 30 days after publication in the Federal Register during which either or both Houses of Congress are in session. We will publish notification of the effective date in the Federal Register.

FOR FURTHER INFORMATION CONTACT:

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Legal information: Laura McFarland, Senior Counsel, Office of General Counsel, (703) 883-4020, TTY (703) 883-4056.

SUPPLEMENTARY INFORMATION:

I. Objective

The objective of the final rule is to improve shareholder access to district financial information by providing an additional method of presenting financial information on a bank's related associations to those banks preparing annual financial statements on a stand-alone basis.

II. Background

The Farm Credit Act of 1971 (Act), as amended¹, authorizes the FCA to issue regulations implementing the Act's provisions. Our regulations are intended to ensure the safe and sound operation of Farm Credit System (System) institutions and to govern the disclosure of financial information to shareholders of, and investors in, the System. Congress explained in section 514 of the Farm Credit Banks and Associations Safety and Soundness Act of 1992² that disclosures of financial information, among other disclosures, provide System shareholders with information necessary to better manage their institution and make informed decisions regarding its operations.

¹ Pub. L. 92-181, 85 Stat. 583 (1971), 12. U.S.C. 2001, et seq.

² Pub. L. 102-552, 106 Stat. 4131 (1992).

We issued a proposed rule on December 12, 2019, asking for comments on proposed changes to 12 CFR 620.2.³ Specifically, we proposed allowing Farm Credit banks to use a supplement for disclosure of combined districtwide (bank and related association) financial information in lieu of a footnote when issuing stand-alone annual financial statements. As proposed, the supplement would be considered part of the bank's annual report and therefore be distributed at the same time as the annual report, and covered by its accuracy, distribution, and internal control requirements. The comment period for the proposed rule closed on March 9, 2020.

III. Comments and Our Responses

We received two comment letters on our proposed changes to § 620.2(g)(2). One letter came from CoBank, ACB (CoBank), a System institution, and one letter came from the American Bankers Association (ABA). Both letters supported FCA's objective for the rulemaking but asked for changes to what was proposed. We discuss these comments to our proposed rule and our responses below. However, after consideration of all the comments, we are making no changes and final all provisions as proposed.

³ 85 FR 647

A. Treatment of supplement as part of the annual report.

We proposed requiring the inclusion of the combined districtwide financial information via a supplement to be considered part of the annual report. CoBank expressed support for the flexibility of using either a supplement or footnote for discussion of districtwide financial information within the bank's annual report. However, CoBank requested removal of the proposed requirement that the supplement be considered part of the annual bank stand-alone report, asking that the supplement be a separate report. CoBank gave several reasons for the request and we address each of the reasons given by CoBank later in this preamble, but generally respond here by explaining that the supplement was proposed as an alternative presentation format to using a footnote as provided under our existing regulations. In keeping with this existing regulatory requirement, we proposed keeping the combined districtwide financial information as an essential part of the annual report itself, whether presented as a footnote or supplement.

We explained in the preamble to the proposed rule that use of a supplement instead of a footnote was not creating a new report, but merely giving the alternative presentation method requested by the four Farm Credit

banks.⁴ Because by its nature a footnote is indelibly part of a report, we proposed concurrent distribution when presentation of districtwide information is done through a supplement to ensure it received the same treatment as if presented in a footnote. Meaning, whether a supplement or footnote, the contents would be part of the annual report, distributed with the annual report pursuant to 12 CFR 620.4, and therefore included in the annual report signature, certification, and internal controls requirements of 12 CFR 620.3. Additionally, we believe that shareholders need both the bank-only financial information and combined districtwide financial information at the same time to foster a better understanding of the bank and its district operations. All the financial information - bank-only and combined districtwide financial information - needs to be available at the same time to accomplish that goal.

1. Comingling districtwide data with bank only information

CoBank commented that it believes the inclusion of the supplement as part of the bank's annual report renders the bank's disclosures misleading to its investors because the

⁴ Refer to the proposed rule at section II, "Background" (85 FR 647, January 7, 2020).

bank has lending activities beyond the associations. CoBank has the unique status of being the only System institution possessing Title III authorities, resulting in Title III voting stockholders that are not System associations—these stockholders are called “cooperative association stockholders” (CA stockholders). CoBank explained that, because the districtwide disclosures exclude its Title III lending activities, an investor might interpret the different disclosure treatment as being required due to accounting or financial reasons. CoBank also claimed its CA shareholders could mistakenly conclude there are multi-tiered classes of common stockholders due both to the heightened prominence of the district financial information resulting from use of a supplement over a footnote and the equity interests of this group of stockholders not being reflected in the districtwide information.

We disagree with CoBank’s stated concern. A clearly presented supplement or footnote would label the information in a manner to avoid an investor or shareholder misreading the data. Although CoBank has both System association shareholders and CA stockholders, the districtwide financial information presented in a supplement or footnote further supports the bank’s discussion of the components of its operations. Throughout

its annual report, CoBank discusses the distinctions between its association shareholders and CA stockholders. The disclosure of districtwide financial information continues the bank's efforts to clarify its operations to its association shareholders and CA stockholders by reducing confusion on its district operations. In addition, both the footnote and the supplement specify the scope of the financial information presented, which avoids confusion with CoBank's lending activities with CA stockholder entities.

2. Delay in receipt of districtwide information

CoBank objected to distributing the supplement concurrently with the annual report because receipt of the districtwide information may be delayed, making the entire annual report late. CoBank stated that any delay in issuing the annual report could adversely affect CoBank's credibility in the capital markets, which in turn could imperil access to third-party capital resources. CoBank added that it envisioned sending both items together except when there was a delay in obtaining the districtwide data.

As the funding bank for its associations, we believe CoBank can minimize the potential for financial reporting delays and other issues at its related associations. By using its ongoing monitoring and other supervisory

activities, each bank can identify and assess the impact of potential delays and other issues on the preparation of annual reports and take proactive steps to minimize the potential consequences should a delay or other issue occur. Further, effective internal controls over financial reporting at a bank and its related associations reduces the likelihood of delays. We encourage the banks to proactively utilize measures that improve its districtwide financial reporting processes, while decreasing any issuance risks. Separately, investors from the capital markets, just like System shareholders, must obtain timely, reliable financial information to make informed investment decisions when purchasing System securities. We do not believe that separately issuing bank-only and combined districtwide financial information accomplishes that goal. By concurrently issuing combined districtwide information with the bank's annual report, the investors receive a timely and complete view of the bank's operations and obligations in order to price System securities accordingly.

3. Different accounting treatment

We proposed clarifying that the current § 620.2(g)(2) option for banks to issue the related associations' financial information on an unaudited basis extends to all

the financial information provided for the related associations, whether in a footnote or supplement. We also proposed language to specify that all information provided through use of either a footnote or a supplement would be considered part of the bank's annual report and therefore included in the distribution, signature, certification, and internal control assessments of the annual report. CoBank questioned treating the supplement as part of the annual report's financial certification when separate auditing protocols are applied to the bank only financial information. CoBank explained that it appeared inappropriate to include unaudited districtwide financial information within the report when the bank-only financial information is audited. CoBank added that it had no disagreement with the districtwide information being unaudited, only with treating it as part of the annual report.

We disagree with CoBank's comment that the bank's annual reports, which contain both audited and unaudited information, is contradictory or misleading. The rule does not change the current regulatory provision that the combined bank and association financial information may be unaudited, nor does it change the requirement for the bank to disclose the basis of presentation for the districtwide

financial information. Additionally, the bank-only component of the annual report also contains both audited and unaudited financial information. For example, management's discussion and analysis is a required unaudited element, whereas a bank's financial statements are an audited element of the annual report. We also remark that Generally Acceptable Accounting Principles allow the inclusion of both audited and unaudited information in an annual report. As a result, we believe our rule provides consistent application of accounting and reporting standards across all elements of a bank's annual report. Also, we believe inclusion of districtwide financial information within the annual report, as either a footnote or supplement, bolsters the disclosure purpose of the annual report.

B. Additional disclosures.

In the preamble to the proposed rule we listed our expectations regarding the contents of the districtwide information provided as part of a bank's annual report. The ABA expressed strong support for increasing districtwide disclosures and asked that the recommended information listed in the preamble to the proposed rule be required and issued in a tabular format to permit more extensive comparison of association financial results within the

bank's district. The preamble did not discuss or propose the recommended information as regulatory text and thus we do not feel that it would be appropriate to now add these recommendations as new requirements for the final rule. We do not believe that a prescriptive approach regarding the contents of the districtwide information provided as part of a bank's annual report is appropriate. Rather, while some general uniformity is appropriate, FCA recognizes that districtwide financial disclosures may vary among the banks. We also reiterate our expectations that district financial information at a minimum, include:

- The nature of business relationships between System entities within the bank's district;
- Summary of District financial information for the preceding three years;
- Summary of district loan portfolio, discussing concentration risks and significant changes in credit quality, nonperforming assets, past due loans, loan loss allowance and reserves, and loan aging analysis within the district as compared to previous years.
- A description of combined association investments;
- Districtwide capital levels and regulatory ratios;

- Summary of key districtwide income statement line items and profitability measures; and
- A description of any qualified and nonqualified districtwide defined pension plan(s), including each plan's current funding status, accrued benefit obligation and projected benefit obligation, and key actuarial assumptions.

We believe an annual report, with the above list of items, will provide the most meaningful transparency on the financial condition of each Farm Credit District.

The ABA also asked that the rule require increased discussion within the annual report of supervisory and enforcement actions. FCA existing regulation § 620.5(c) currently requires the disclosure of enforcement actions as part of an annual report. We proposed no changes to this rule provision so are not making any changes in response to the comment.

IV. Regulatory Flexibility Act and Major Rule Conclusion

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that this final rule would not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its related associations, has assets and annual income in

excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

Under the provisions of the Congressional Review Act (5 U.S.C. 801 *et seq.*), the Office of Management and Budget's Office of Information and Regulatory Affairs has determined that this final rule is not a "major rule," as the term is defined at 5 U.S.C. 804(2).

List of Subjects in 12 CFR Part 620

Accounting, Agriculture, Banks, Banking, Reporting and recordkeeping requirements, Rural areas.

For the reasons stated in the preamble, part 620 of chapter VI, title 12 of the Code of Federal Regulations are amended as follows:

PART 620--DISCLOSURE TO SHAREHOLDERS

1. The authority citation for part 620 continues to read as follows:

Authority: Secs. 4.3, 4.3A, 4.19, 5.9, 5.17, 5.19 of the Farm Credit Act (12 U.S.C. 2154, 2154a, 2207, 2243, 2252, 2254); sec. 424 of Pub. L. 100-233, 101 Stat. 1568; sec. 514 of Pub. L. 102-552, 106 Stat. 4102.

Subpart A--General

2. Amend § 620.2 by revising paragraph (g) to read as follows:

§ 620.2 Preparing and filing reports.

* * * * *

(g) Each Farm Credit institution shall present its reports in accordance with generally accepted accounting principles and in a manner that provides the most meaningful disclosure to shareholders.

(1) Any Farm Credit institution that presents its annual and quarterly financial statements on a combined or consolidated basis shall also include in the report the statement of condition and statement of income of the institution on a stand-alone basis. The stand-alone statements may be in summary form and shall disclose the basis of presentation if different from accounting policies of the combined or consolidated statements.

(2) Any Farm Credit bank that prepares its annual financial statements on a stand-alone basis must also provide financial information on its related associations as part of its annual report. The information on the related associations must be presented on a combined basis with the bank's financial information and, at a minimum, include both a condensed statement of condition and a statement of income. The combined bank and association

financial information may either be in the footnotes of the bank's annual report or located in a supplement to the report. All combined information provided through either a footnote or a supplement will be considered part of the bank's annual report, subject to the same annual report preparation, distribution, and accuracy requirements of part 620.

(i) The combined bank and association financial information may be unaudited but must disclose the basis of presentation if different from accounting policies used for the bank-only financial statements.

(ii) If the combined bank and association financial information is presented in the form of a supplement, the supplement must be referenced within the bank's annual report and accompany the annual report when distributed.

Date: September 9, 2020 Dale Aultman,
 Secretary,
 Farm Credit Administration Board.